Supreme Court, U. S.
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In the Supreme Court of the United States

October Term, 1978
No. 78-138

COMMONWEALTH OF PENNSYLVANIA,
Appellee

v.

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant

On Appeal From the Supreme Court of Pennsylvania

MOTION TO DISMISS OR AFFIRM

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STATUTE:

Pennsylvania Corporate Net Income Tax Act of 1935, P.L. 209, Section 2(c)(3), as amended, 72 P.S. §3420b2(c)(3) 4, 7, 8

MISCELLANEOUS:

"Taxing Memorandum Number 83 on Foreign Tax Credits", March 10, 1972 .....5, 6, 12

QUESTIONS PRESENTED

1. Where the Pennsylvania Corporate Net Income Tax Act requires that the tax base be the net income as returned to and ascertained by the Federal Government, and where a taxpayer voluntarily elects to take its foreign taxes paid as a credit rather than as a deduction for its federal tax purposes so that the taxes are *not* reflected in net income as returned to and ascertained by the Federal Government, can the tax act be declared unconstitutional as violative of the Equal Protection Clause of the United States Constitution?

2. Where agents of the Commonwealth of Pennsylvania have made a few isolated mistakes or errors in judgment in the administration of the corporate net income tax, is there a violation of Equal Protection on the theory that there has not been substantial uniformity?

MOTION TO DISMISS OR AFFIRM

The Appellee moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Pennsylvania on the ground that the appeal does not raise any substantial federal question.

STATEMENT OF THE CASE

Westinghouse Electric Corporation, hereinafter called Appellant, is a Pennsylvania corporation engaged in the manufacture and sale of equipment and appliances for the generation, transmission, utilization and control of electricity.

For the calendar year 1969, Appellant filed a Federal Consolidated U.S. Corporation Income Tax Return, Form 1120, and took as a credit all foreign taxes withheld/paid on foreign income.

Appellant timely filed with the Pennsylvania Department of Revenue its Corporate Net Income Tax Report for the year 1971, Form RCT-104, which included under gross income:

Federal Line	*Item*	*Amounts*
1	Gross Sales	$3,107,607,415
4	Dividends	45,804,743
6	Other Interests	5,297,554
8	Gross Royalties	18,853,848

Appellant did not deduct on its Pennsylvania Form RCT-104 the foreign taxes withheld and/or paid at source on foreign dividends, interest, and royalties included as gross income:

Item	*Foreign Gross Income*	*Foreign Taxes Withheld/Paid*
Foreign Dividends	$17,671,904	$1,941,467
Foreign Royalties	18,784,582	1,955,922
Foreign Interests	1,722,685	169,318
Foreign Sales and Miscellaneous Income	415,743	116,417
Total	$38,594,914	$4,193,124

The Pennsylvania Corporate Net Income Tax Act of 1935, P.L. 209, Section 2(c) (3), as amended, 72 P.S. §3420b2(c) (3), provides:

> "Where a corporation in any tax year beginning on or after the first day of January, one thousand nine hundred fifty-six, engages in a separate business outside of Pennsylvania, or owns property having a situs outside of Pennsylvania, which business or property bears no relation to the exercise of the Pennsylvania franchise, the department, with the approval of the Auditor General, may determine the base for the tax imposed by this act for the tax year by excluding from the net income of such corporation as returned to and ascertained by the Federal Government, the net income from the business or property which bears no relation to the exercise of the Pennsylvania franchise. The deduction allowed by this section for dividends received from any other corporation shall be limited to those dividends which remain in the net income after the exclusion hereinbefore authorized in this paragraph. The net income which remains, after the exclusion and deductions authorized in this paragraph, shall be subject to allocations and apportionments as provided in this section using only those factors which pertain to that portion of the net income being allocated and apportioned."

"Settlement" of the tax was made by the Department of Revenue on November 23, 1970, which settlement reflected the tax based upon net income as returned to and ascertained by the Federal Government. Since the taxpayer elected to take its foreign taxes as a credit rather than as a deduction for federal tax purposes, said credit was not reflected in federal taxable income, and, hence was not reflected in net income for Pennsylvania corporate net income tax purposes.

On March 10, 1972, Peter Capataides, Director, Bureau of Corporation Taxes, Commonwealth of Pennsylvania, issued *"Taxing Memorandum* Number 83 on Foreign Tax Credits", stating:

> "On the basis of recent decisions by the Board of Finance and Revenue foreign tax credits are allowed as a deduction for purposes of computing Pennsylvania corporate net income tax. The deduction would appear on line 2(c) 'other allowable deductions' of the corporate net income tax return.
>
> These foreign tax credits may be taken as a deduction even though for federal tax purposes they were claimed as a tax credit rather than as a deductible expense."

On April 18, 1972, and April 2, 1973, the above Taxing Memorandum Number 83 was changed slightly. On April 11, 1973, Taxing Memorandum Number 83 was rescinded.

It is most important to note that Appellant's 1969 Corporate Net Income Tax Report was filed, under an "extension granted" on October 15, 1970, which was before the issuance on March 10, 1972, of Taxing Memorandum Number 83.

Appellant filed on May 5, 1972, a petition for refund with the Board of Finance and Revenue (first level of review) requesting a refund of $194,115.23, based upon a deduction in the amount of $5,962,633, which represented foreign taxes paid on foreign income.

By order of August 27, 1975, the Board of Finance and Revenue denied the petition with the designees for the Secretary of the Commonwealth and the State Treasurer dissenting. The order of the Board was rendered after Taxing Memorandum Number 83 was rescinded.

Appellant timely filed its appeal and specification of objections with Commonwealth Court on September 19, 1975. Following the filing of a stipulation of facts and argument, Commonwealth Court, in a unanimous opinion, dated February 2, 1977, ruled in favor of the Commonwealth on all issues.

An appeal was subsequently taken to the Pennsylvania Supreme Court which affirmed the Commonwealth Court with one Justice dissenting.

Appellant then filed the instant appeal.

SUMMARY OF ARGUMENT

The Pennsylvania Corporate Net Income Tax Act provides that the base of the tax is net income as returned to and ascertained by the Federal Government.

Since the Appellant voluntarily elected to take foreign taxes paid as a credit rather than as a deduction for federal tax purposes so that the foreign taxes were not reflected in net income as returned to and ascertained by the Federal Government and consequently were not in the Corporate Net Income Tax base, no violation of the Equal Protection Clause exists because the tax act is not invidiously discriminatory or palpably arbitrary.

Where there is substantial uniformity in the administration of taxes, a few mistakes made by officials of the Commonwealth do not create a violation of the Equal Protection Clause of the United States Constitution.

ARGUMENT

THIS APPEAL PRESENTS NO SUBSTANTIAL FEDERAL QUESTION WARRANTING REVIEW BY THIS COURT

A. The Pennsylvania Corporate Net Income Tax Act Does Not Violate the Equal Protection Clause of the United States Constitution Since the Tax Act Provides as to All Taxpayers That the Tax Base Is Net Income as Returned to and Ascertained by the Federal Government

The Appellant argues that the Pennsylvania Corporate Net Income Tax violates the Equal Protection Clause because taxpayers like the Appellant who elect to take foreign taxes as a credit for federal tax purposes are denied the deduction for Pennsylvania Corporate Net Income Tax purposes while those taxpayers who take the foreign taxes as a deduction for federal tax purposes are allowed the deduction.

The Pennsylvania Corporate Net Income Tax Act requires that one must look to the "net income of such corporation as returned to and ascertained by the Federal Government."

A taxpayer pays foreign taxes which it may claim either as a deduction or as a credit for federal tax purposes. If a corporation takes the foreign taxes as a deduction, that deduction will be taken into account and

reflected in its net income as returned to and ascertained by the Federal Government. However, if the corporation takes the foreign taxes as a credit against its federal taxes, that credit would neither be taken into account nor reflected in its net income as returned to and ascertained by the Federal Government since it would be applied subsequently as a credit against the federal tax.

The taxpayer in this case voluntarily chose to take its foreign taxes as a credit rather than as a deduction for federal tax purposes. By making such an election, the foreign taxes do not come into play in arriving at its net income as returned to and ascertained by the Federal Government. The Commonwealth of Pennsylvania did not, nor could not, consider the foreign taxes as taken by a credit since the Commonwealth must look to net income as returned to and ascertained by the Federal Government pursuant to statute.

A constitutional violation cannot be imputed to the Commonwealth because of the voluntary action of the Appellant in taking the foreign taxes paid as a credit rather than as a deduction for federal tax purposes.

This Court in *Ohio Oil Company v. Conway*, 281 U.S. 146, 159 (1930), generally discussed the Equal Protection Clause as it related to State taxation:

> "The States, in the exercise of their taxing power, as with respect to the exertion of other powers, are subject to the requirements of the due process and equal protection clauses of the Fourteenth Amendment, but that Amendment imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to schemes of taxation . . . In levying such taxes, the State is not required to

resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value. To hold otherwise would be to subject the essential taxing power of the State to an intolerable supervision, hostile to the basic principles of our Government and wholly beyond the protection which the general clause of the Fourteenth Amendment was intended to assure."

See also *Kahn v. Shevin*, 416 U.S. 351 (1974).

In order for a violation of the Equal Protection Clause to exist, the taxpayer must establish that the challenged tax act is invidiously discriminatory and palpably arbitrary. *Lehnhousen v. Lake Shore Auto Parts Company*, 410 U.S. 356 (1973). The Pennsylvania Corporate Net Income Tax, in using net income as returned to and ascertained by the Federal Government as its base, is neither arbitrary nor discriminatory since the Appellant by its own voluntary election, took its foreign taxes as a credit rather than as a deduction for federal tax purposes so that it would not be reflected in the Pennsylvania tax base. The taxpayer made the election because of the advantage it would gain for federal tax purposes but, since it did not gain an advantage for its Pennsylvania Corporate Net Income Tax purposes, the taxpayer raises objection.

As this Court stated on page 358 of its opinion in *Lehnhousen v. Lake Shore Auto Parts Company*, supra:

> "We could strike down this tax as discriminatory only if we substituted our judgment on facts of which we can be only dimly aware for a legislative judgment that reflects a vivid reaction to pressing fiscal problems."

The Pennsylvania Corporate Net Income Tax does not violate the Equal Protection Clause of the Constitution of the United States.

B. Mistakes or Errors in Judgment by Agents of the Commonwealth of Pennsylvania in the Administration of the Corporate Net Income Tax Act Do Not Create a Violation of Equal Protection

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The Appellant also argues that there was a violation of Equal Protection on the theory that one official in the Department of Revenue and one official in the Department of Justice administratively allowed the deduction to certain other taxpayers who took foreign taxes as a credit for federal tax purposes.

It is true that one official in the Department of Revenue, namely, the Director of the Bureau of Corporation Taxes, did issue a Taxing Memorandum Number 83 which, through its effective period, granted taxpayers relief.

It is extremely important to note that the memorandum in question was uniformly applied through the period in which it was in effect. There is no question that there was a mistake in promulgating the memorandum since it subsequently was rescinded. Because there were some taxpayers who filed tax reports at a time either before or after the effective period of the memorandum, this is no basis for an argument that all taxpayers who filed during the period were given favored treatment at the expense of other taxpayers.

The taxing memorandum was uniformly applied through the period in which it was effective and, therefore, there has been substantial uniformity in this case.

The Appellant also argues that there was a discrimination because two other taxpayers, namely, Coca-Cola Company and H. J. Heinz Company, were granted relief for the same year in question. These two taxpayers should have only been given relief for the periods in which Taxing Memorandum Number 83 was in effect. However, through a mistake, they were granted relief for periods that were beyond the effective period of Taxing Memorandum Number 83. Because of these two isolated mistakes, where a taxpayer through an error was given relief, the Appellant would now have that error extended so that all other taxpayers would gain that advantage.

The Commonwealth does not dispute that it was a mistake for the Director of the Bureau of Corporation Taxes to promulgate the memorandum and for the official in the Justice Department to stipulate all tax years on appeal for the two taxpayers. It is also undisputed that these two officials acted in good faith when they made the mistakes.

This Court has held that there is not a violation of equal protection or uniformity where a tax official has made a mistake in the administration of the tax act. In *Charleston Federal Savings and Loan Association v. Alderson*, 324 U.S. 182 (1945), the Court laid down the following principle on page 190 of its opinion:

> "Nor does the equal protection clause prohibit inequality in taxation which results from mere mistake or error in judgment of tax officials. . ."

The general principle espoused in the foregoing case was elaborated upon in greater detail in the case of *Sunday Lake Iron Company v. Township of Wakefield*, 247 U.S. 350 (1918), where the Court stated on page 353 of its opinion:

> "It is clear that mere errors of judgment will not support a claim of discrimination. There must be something more—something which in effect amounts to an intentional violation of the essential principle of practical uniformity. The good faith of such officers and the validity of their actions are presumed; when assailed, the burden of proof is upon the complaining party."

Further, in *Rowley, Treasurer of Converse County, Wyoming et al. v. Chicago & Northwestern Railway Co.*, 293 U.S. 102 (1934), this Court even went further when it stated on page 111 of its opinion:

> "There must be something that amounts to an intention, or the equivalent of fraudulent purpose, to disregard the fundamental principle of uniformity."

Based upon the foregoing cases, the Appellant's second argument is also without merit.

CONCLUSION

The Appellant's jurisdictional statement does not raise any substantial federal question and the Commonwealth submits that the appeal of the Appellant should be dismissed and the judgment of the Pennsylvania Supreme Court be affirmed.

Respectfully submitted,

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